

RESIDENTIAL UTILITY CONSUMER OFFICE (RUCO)



**Serving the Arizona Residential Consumer
Since 1983**

**Twenty-Second Annual Report
2003-2004**

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DIRECTOR'S LETTER

RESIDENTIAL UTILITY CONSUMER OFFICE

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Janet Napolitano
Governor

Stephen Ahearn
Director

October 31, 2004

The Honorable Janet Napolitano, Governor
The Honorable Ken Bennett, President, Arizona Senate
The Honorable Jake Flake, Speaker, Arizona House of Representatives

Re: Fiscal Year 2004 RUCO Annual Report

I am pleased to submit this report of the activities of the Residential Utility Consumer Office for this Fiscal Year. It has been a very successful year for our advocacy of important consumer issues before the Arizona Corporation Commission.

This Annual Report covers activity through June 30, 2004. The "Case Summaries" section also describes those cases open as of July 1, foretelling in part the Fiscal Year 2005 report.

It is understood that recent Legislative action removes the obligation for RUCO to put together these Annual Reports. However, insomuch as we continually capture and retain the data and other information contained herein for record-keeping purposes and in anticipation of future audits, our generating and distributing such a report in an electronic format requires virtually no additional staff time, and delivers a value for Arizona consumers at zero incremental financial impact.

I would like to note my personal pride in the staff of this smallish agency, and to specifically remark upon their professionalism and their demonstrated ability to successfully and consistently achieve our mission of effective representation of residential consumer interests.

Sincerely,

Stephen Ahearn

Stephen Ahearn
Director

SA:hs

RUCO ADMINISTRATIVE AND SUPERVISORY PERSONNEL

DIRECTOR

Stephen Ahearn was appointed by Governor Janet Napolitano as Director of the Arizona Residential Utility Consumer Office (RUCO) on January 6, 2003. He is a native Arizonan, born on Davis-Monthan Air Force Base in Tucson, and raised in Phoenix. He received his undergraduate degree (B.A., International Relations) from Pomona College in Claremont, California, and his graduate degree (MBA, International Finance) from UCLA.

Mr. Ahearn spent his early career after undergraduate school in operational, finance and management positions for Los Angeles-based manufacturing firms. In the mid-1980's, he moved back to Arizona and co-founded companies that manufactured non-toxic, environmentally-sensitive pesticides, building materials and recycled plastics products.

In 1990 he joined the Arizona Department of Commerce Energy Office as the Manager of Planning and Policy. In that capacity he was responsible for implementation of the legislatively-mandated state Energy Policy. He began to write and speak extensively about electric industry restructuring as early as 1994, and was recruited to the Arizona Corporation Commission in late 1997 to advise the staff on electric industry competitive matters and to act as the agency's liaison to the Legislature.

He left the staff of the Corporation Commission in late 1999 to run for the office of Corporation Commissioner. In the period just prior to being appointed Director of RUCO, he had founded Ahearn & Associates, a consulting firm specializing in general business planning with a focus on renewable energy project development and representation of renewable energy firms.

DEPUTY DIRECTOR

Ernest Nedd is a native Phoenician and graduate of the Phoenix Elementary School District No. 1 and Phoenix Union High School. He attended Brown University in Providence, RI, and after serving in the U.S. Army, including a tour of duty in Vietnam, Mr. Nedd returned to Arizona and earned a B.S. degree in Political Science from Arizona State University. He then attended the College of Law at Arizona State and earned his J.D. degree in 1976.

Mr. Nedd has previously held positions with the State of Arizona as an Assistant Attorney General, Assistant Commissioner of the Real Estate Department and Chief Hearing Officer of the Department of Liquor Licenses and Control. He has served as a member of the City of Phoenix Board of Adjustment, the Phoenix Inner City Planning Committee and the Phoenix Transportation Advisory Committee. Mr. Nedd also is a former Chairman of the Board of Directors of Valle del Sol, Inc. and he has served on the Board of Directors of the Valley Christian Centers.

Mr. Nedd is currently a resident of the Coronado Historic Neighborhood in Central Phoenix.

CHIEF COUNSEL

Scott Wakefield has been RUCO's Chief Counsel since 1998. He came to RUCO after serving as a Hearing Officer at the Corporation Commission, where he handled numerous rate case proceedings, consumer complaint hearings, and matters involving competition in the utility industry.

Mr. Wakefield is a member of the Lorna Lockwood Inn of Court. He received his Juris Doctorate cum laude from Arizona State University in 1990, and his Bachelor of Science degree in accounting magna cum laude from Arizona State in 1987. He has served on the board of directors for two non-profit organizations, and he currently volunteers with Recording for the Blind and Dyslexic. He grew up and continues to live in Tempe.

Prior to his tenure as a hearing officer, Mr. Wakefield investigated and prosecuted investment fraud with the Corporation Commission's Securities Division. His work there resulted in caselaw outlining when investments in limited liability companies can be considered securities under the Arizona Securities Act.

Mr. Wakefield is knowledgeable on the process to appeal decisions of the Corporation Commission, and lead the first RUCO success in appealing a Commission decision. He participates in RUCO's speaker's bureau, and has made numerous presentations on utility regulation and practice before the Arizona Corporation Commission in legal continuing education seminars.

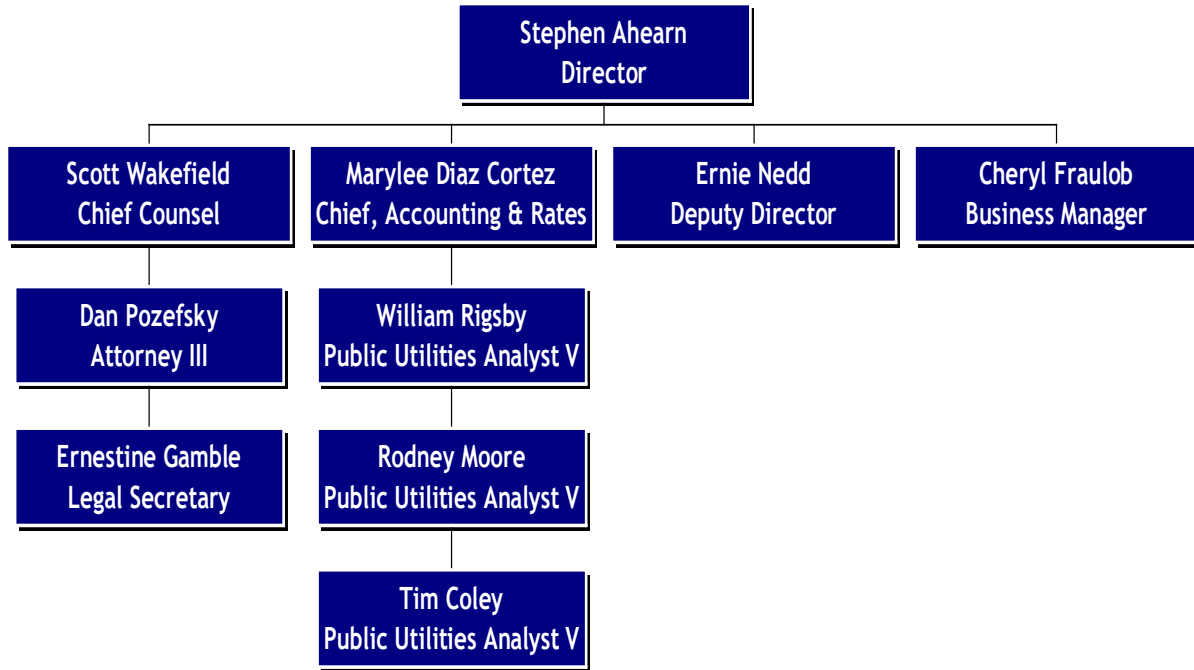
CHIEF ACCOUNTING & RATES

Marylee Diaz Cortez joined the Residential Utility Consumer Office in 1992, and has served as head of the technical division for the past ten years. She is a graduate of the University of Michigan and a Certified Public Accountant licensed in Arizona and Michigan.

Prior to joining RUCO, Ms. Diaz Cortez worked for the public accounting firm of Larkin and Associates in the Detroit, Michigan area. Her private practice included regulatory consulting services. Between her experience at Larkin and Associates and RUCO she has audited over 80 public utility companies including electric, gas, telephone, water, and sewer. She has provided expert testimony in as many cases.

Ms. Diaz Cortez works with a staff of three in-house auditors as well as outside expert witnesses. She is responsible for overseeing all testimony filed before the Arizona Corporation Commission. In her 12 years with RUCO, she has worked diligently and successfully to protect consumers from unjust utility rates.

RUCO'S Organization Chart



RUCO AND THE REGULATORY PROCESS

The Residential Utility Consumer Office (RUCO) was established by the Arizona Legislature in 1983 to represent the interests of residential utility ratepayers in rate-related proceedings involving public service corporations before the Arizona Corporation Commission (Commission).

Historically, utilities have had the exclusive right to provide services in designated areas. As legal monopolies, utilities are regulated to ensure that the public is charged just and reasonable prices. To establish the utilities' rates and charges, the Commission conducts public hearings and examines evidence and testimony presented by various concerned parties. RUCO represents the interests of Arizona's residents in these proceedings.

Every utility rate increase application filed with the Commission, regardless of the size of the utility, receives a preliminary review by RUCO. As a matter of policy, RUCO always intervenes and participates in rate cases involving Arizona's largest utilities. Intervention in the cases of smaller companies is decided on a case-by-case basis, with particular attention to the size of the increase sought, the rate history of the utility, and the availability of resources at RUCO. Generally, RUCO does not formally intervene in small cases to avoid causing unnecessary legal expenses for the small utility and its ratepayers.

RUCO is authorized 12 full-time employees, and often contracts with consultants for assistance in analyzing utilities' requests for changes in rates and preparing testimony.

THE RATEMAKING PROCESS

The rates charged by Arizona's investor-owned utilities are established by the Commission. The Commission authorizes a utility to charge rates, which will recover expenditures which are appropriate and prudently incurred, and which provide an opportunity to earn fair return on the utility's capital investment.

A utility initiates the process to obtain a rate increase by filing an application with the Commission. The application must be based on a "test year" of actual expenses and investment during a recent twelve-month period. All of the utility's cost data are drawn from its own records. The Commission requires that the utilities follow a standardized system of accounting procedures that assures that the data can be easily reviewed and verified by the Commission, RUCO and others.

In its application, a utility may propose certain adjustments to its actual test year costs and investment. Historical costs and investment may be adjusted by annualizing changes which occurred during the test year, such as payroll increases or tax changes, making them appear as if they had been in effect for the entire year. In addition, historical costs may be normalized to eliminate the effects of abnormal variations that actually occurred during the test year, such as weather-related changes in consumption. Other adjustments may be proposed to include the effects of known and measurable changes that occurred after the end of the test year, such as wage increases and certain costs related to recently completed construction projects.

Upon receiving the utility's application and written summary or testimony, the Commission's Staff reviews the application to confirm that it contains all the necessary accounting information. If the application is complete, the Commission's Staff prepares a letter of

sufficiency. The determination of sufficiency triggers the Commission's "time clock" rule, which establishes a deadline by which the Commission Staff must file its Staff Report or testimony on the application, and a deadline by which the Commission must issue a final order on the application. A hearing date is fixed for an application that requires a hearing.

After the application is determined sufficient, RUCO and other interested parties are permitted to intervene in the case. As intervenors, parties have the right to obtain additional information from the utility to assist in their review of the application. In addition, intervenors may present evidence of their own on the application and may have their attorneys cross-examine other parties' witnesses and submit written briefs, which present their positions on the issues in the case.

When the Commission Staff has completed its investigation, it issues recommendations in a Staff Report or written testimony. Intervenors also provide their recommendations in the form of written testimony prepared by their analysts or consultants. The utility has the opportunity to respond through the filing of additional written testimony of its own.

In many cases, prior to the hearing on the application, the Commission holds public comment sessions in the service territory of the utility. These meetings are intended to allow customers to express their opinions about the rate request and to provide the Commission with information that the customers feel is relevant to the case. It is not required, nor is it expected, that customers making comments at these meetings be represented by counsel.

The Commission then holds a formal hearing on applications which require hearings. At the hearing, the utility, the Commission Staff, RUCO, and other intervenors present witnesses, offer evidence, and conduct cross-examination of other parties' witnesses on the issues raised in the filed reports and testimony. Issues commonly disputed in rate cases include: which expenses should be charged in rates to ratepayers; what a normal or prudent level of expenses should be; whether all of the utility's investments in physical facilities were prudently made and whether the facilities are needed for the provision of utility services; how much of a return the utility's shareholders should be allowed to earn on their investment; and how the cost of providing service should be allocated to, and recovered from, the utility's various classes of customers.

After the hearing is concluded, the Commission's Administrative Law Judge reviews the evidence and the parties' arguments and issues a Recommended Order. The Recommended Order sets forth a recommended decision on all contested issues and recommends how much of a rate increase, if any, the utility should receive. The parties are permitted to file exceptions to the Recommended Order, asking the Commission to disregard the conclusions of the Recommended Order and suggesting an alternate resolution. At a public meeting, the Commission considers the Recommended Order, and the parties' exceptions to it. The Commission can adopt or deny the Recommended Order as originally written, incorporate any of the suggested exceptions, or make its own amendments.

After the Commission issues its final decision, the parties have twenty days to request the Commission to reconsider its decision. If the Commission declines to grant a rehearing, the parties may appeal the decision to the Arizona Court of Appeals. Decisions of the Court of Appeals may be appealed to the Arizona Supreme Court. Filing an appeal does not prevent the rates approved by the Commission from taking effect.

RUCO'S BUDGET

RUCO receives no money from the general tax fund. Rather, RUCO receives 100 percent of its operating budget from assessments of large utility companies that may, in turn, pass those charges on to their residential customers. In this way, those who benefit from RUCO's work fund its work. The utility ratepayers who pay these small assessments should consider their money well spent. The following reflects FY 2004 activity for the appropriation year 2004, excluding the professional witness budget and the approved amount for FY 2005.

EXPENDITURE CATEGORIES	ACTUAL 2004	APPROVED 2005
PERSONAL SERVICES	\$664,500	\$673,700
EMPLOYEE EXPENSES	\$162,800	\$174,100
ALL OTHER	\$318,400	\$320,400
TOTAL	\$1,145,700	\$1,168,200

RUCO'S FUNDING MECHANISM

Pursuant to A.R.S. § 40-401.01, funding of RUCO is accomplished through an assessment made annually by the Commission. Each utility with annual residential revenues in excess of \$250,000, except those not required to hold Certificates of Convenience and Necessity, is assessed.

The disposition of assessment proceeds is governed by A.R.S. § 40-409. All monies received by the Commission under the provisions of A.R.S. § 40-401.01 are paid to the State Treasurer and placed in the RUCO Revolving Fund. Monies in the fund are used, subject to legislative appropriation, to operate RUCO pursuant to A.R.S. § 40-461. Appropriated funds not spent by the end of a fiscal year do not revert to the General Fund. They revert to the RUCO Revolving Fund and are used to calculate the ratepayer assessment for the next fiscal year. Based on the information available at the end of FY 2004, the assessment for FY 2005 was \$1,168,200.

RUCO'S CASE ANALYSES AND INTERVENTIONS

As previously described, RUCO generally seeks to avoid intervening formally in small rate cases. Nevertheless, these cases are analyzed for potential cost impacts on ratepayers. Generally, rate applications for small utilities do not warrant formal RUCO intervention, which could unnecessarily increase costs to small utility ratepayers. The following table illustrates how RUCO's intervention activity over the past fiscal year compares to prior years:

	2000	2001	2002	2003	2004
NUMBER OF CASES ANALYZED	100	102	115	92	86
NUMBER OF RUCO INTERVENTIONS	13	11	14	13	13

RUCO'S IMPACT

The following table illustrates RUCO's impact on rate requests by utilities over the past fiscal year, compared to prior years:

	2000	2001	2002	2003	2004
AVERAGE UTILITY RATE REQUEST (MILLIONS \$)	5.1	33.9	8	10.7	2.2
AVERAGE RUCO RECOMMENDATION	.8	5.9	1.8	7.8	.9
AVERAGE ACC APPROVED RATE	3.1	4.1	3.0	7.7	1.0

CONSUMER EDUCATION AND OUTREACH ACTIVITIES

Throughout calendar year 2004, RUCO has continued to engage in numerous activities designed to reach, interact with and educate residential utility ratepayers. As in the past, the primary vehicle for this outreach has been the agency's website. During 2004, RUCO has continued to upgrade this website to make it more user-friendly and content-rich.

Beginning in July of 2003 and continuing throughout 2004, RUCO has published and distributed a bi-monthly, consumer oriented, electronic newsletter. The RUCO Watchdog is sent to a database of over 450 subscribers and contains information about ongoing rate cases and other items that are of interest to the agency's constituents. The Watchdog is published in both HTML and text formats to accommodate individual subscriber preferences.

RUCO maintains a speaker's bureau and responds to groups requesting presentations about the Office. During 2004 RUCO staff members have made presentations at seminars sponsored by the Safe Drinking Water Section of the Department of Environmental Quality (DEQ) and also provided information at the DEQ Arsenic Technology Fair. RUCO also attends public comment sessions when matters affecting specific communities are pending before the Commission. Office personnel have traveled to Mohave, La Paz, Yavapai, Santa Cruz and Pima counties to attend Commission public comment sessions and to meet with local residential utility consumers. Case-specific information brochures are distributed at these public comment sessions.

In the future, RUCO will seek to take advantage of opportunities presented by the Internet and other technologies to reach out to larger segments of its constituency in a continuing effort to provide useful information to residential utility ratepayers.

CASE SUMMARIES

(Click [here](#) to review a list of acronyms and terms commonly used throughout the descriptions in these Case Summaries).

ON-GOING CASES

(those not closed by June 30, 2004, listed in order of Docket-opening date).

Arizona Public Service - Approval of the Purchase of Generating Assets from PPL Sundance Energy, LLC and for an Accounting Order and Determination of Ratemaking Treatment – Docket No. E-01345A-04-0407

On June 1, 2004, Arizona Public Service Company (APS or Company) filed a joint application with PPL Sundance Energy, LLC (PPL Sundance) requesting Commission approval of APS' purchase of the Sundance Generating Station, and associated assets, from PPL Sundance. The Sundance Generating Station is a 450-megawatt, natural gas-fired power plant in Pinal County, located near the town of Coolidge, approximately 55 miles south of Phoenix. The joint application also requests a certificate of environmental compatibility authorizing the construction of a nominal 600-megawatt natural gas-fired, simple cycle, peaking power generating facility.

RUCO filed a motion to intervene on June 10, 2004. After conducting discovery to gain additional insight into the proposals contained in the Company's application, RUCO filed direct testimony on September 17, 2004. Based on its analysis of the Company's application, RUCO has recommended that APS' request for a deferral accounting order be denied. In support of this recommendation, RUCO's witness discussed normal ratemaking practices, exceptions to normal ratemaking practice, regulatory lag, and the provisions in the proposed APS settlement agreement regarding purchased power expense recoveries. RUCO is also recommending that the Company's request for pre-approval of the ratemaking treatment of the PPL purchase be denied, since it would constitute single issue ratemaking. RUCO instead recommends that the assurance requested by APS can be adequately addressed with a Commission finding in this docket that APS is allowed to acquire the PPL plant and that the Commission will consider recovery of the associated costs in APS' next rate case under traditional cost-of-service principles.

The evidentiary hearing on this matter commenced on October 4, 2004, at the Commission's Phoenix office at 1200 W. Washington and lasted two days. Opening and reply briefs are scheduled, after which the Administrative Law Judge will issue a Recommended Opinion and Order.

APS Application for Pre-approval of Costs in Silver Canyon Pipeline – Docket No. E-01345A-04-0273

On April 9, 2004, Arizona Public Service Company (APS or Company) filed an application with the Commission requesting pre-approval of cost recovery for the Company's participation in Kinder Morgan Energy Partners, LP's (Kinder Morgan) proposed Silver Canyon Pipeline Project. The proposed pipeline will run roughly east to west across Arizona from Window Rock (just north of Interstate 40 on the New Mexico state line) to Ehrenberg (just north of Interstate 10 on the California state line).

In the application, the Company stated that the agreement with Kinder Morgan would provide APS with access to currently less expensive natural gas in the Rocky Mountain supply basin. This will be in addition to the natural gas supplies that APS now receives through pipelines operated by El Paso Corporation. In addition to seeking pre-approval of the Company's additional capacity costs in the Silver Canyon Pipeline, APS also asked that these new costs be recovered from ratepayers through a Power Supply Adjuster (PSA) mechanism that is being proposed in the Company's rate case application that is presently before the Commission. In the event that the PSA is not approved in the pending rate case proceeding, the Company will seek an accounting order that will allow it to record the pipeline costs in a separate deferral account. APS will then seek recovery of the costs in a future rate case proceeding.

APS filed the application pursuant to a Commission policy statement issued on December 18, 2003, in which the Commission recognized that the current need for additional natural gas infrastructure in Arizona warranted the consideration of pre-approval of costs and the adoption of alternative cost recovery methods. A similar request by Southwest Gas Corporation was approved by the Commission on June 24, 2004.

RUCO filed a motion to intervene on May 10, 2004, and hosted two meetings with Commission Staff and representatives from APS prior to the filing of the Staff Report on the matter. On August 16, 2004, Commission Staff filed its Staff Report and proposed order in the docket. On August 31, 2004, the Commission approved APS' request for pre-approval of cost recovery.

UniSource Merger – Docket No. E-04230-03-0933

On December 29, 2003, UniSource Energy Corporation (UniSource) filed a Notice with the Commission of its intent to merge with Saguaro Acquisition Corp. (Saguaro Acquisition) which would result in UniSource becoming a wholly-owned subsidiary of Saguaro Acquisition's holding company. Saguaro Acquisition would cease to exist after the merger, and UniSource would be the surviving corporation. The stock of UniSource would no longer be publicly traded, and UniSource would be privately held post-merger. UniSource is the holding company of Tucson Electric Power Corporation (TEP), UNS Gas, Inc. and UNS Electric, Inc.

The merger, as proposed, would involve a total cash price to be paid by a group of investors (Sage Mountain, LLC, KKR, J.P. Morgan Partners and WCP funds) of \$880 million to be financed, in part (\$556.7 million) by equity contributions from the investors. The balance of the \$1.2 billion purchase price, \$660 million, will be borrowed. Also \$263 million of the total purchase price will be used to improve TEP's equity ratio from its current 25 percent to 40 percent and to fund the transaction costs.

Among the benefits the Company claims will result from the merger, the Company highlights three:

1. A cash infusion of up to \$263 million into TEP which will increase its equity ratio to 40 percent.
2. The commitment to keep UniSource an Arizona-based and operated utility.
3. The ability of the Company to provide safe, reliable and adequate service.

RUCO intervened in this proceeding and filed testimony on behalf of ratepayers. RUCO opposes the proposed merger and has recommended that the Commission reject it. RUCO analyzed the proposed merger and has concluded that the benefits highlighted by the Company are all benefits that the Company has come along way in achieving and will ultimately be fully realized in the near term. Moreover, the merger will introduce more risk without any incremental benefits. Specifically, the merger will increase UniSource's debt leverage placing additional financial pressure on TEP to generate income needed to service UniSource's new debt. Additionally, there are no employment contracts in place which would indicate firm commitments by current management to remain after the merger.

The parties filed their testimony, and a hearing was commenced on June 21, 2004. Post-hearing Briefs were filed and the parties are awaiting a recommended opinion and order from the Administrative Law Judge.

Arizona Public Service Company – Application for an Increase in Rates – Docket No. E-01345A-03-0437

On June 27, 2003, Arizona Public Service Company (APS or Company) filed an application to increase its rates by \$175.0 million¹, or an average of 9.80 percent, to become effective on July 1, 2004. APS indicated that the requested increase includes recognition of the cost of certain generation assets of APS' affiliate Pinnacle West Energy Corporation (PWEC), recovery of \$234 million that APS wrote off pursuant to the 1999 Settlement Agreement of APS' stranded cost application, and recovery of all costs APS prudently incurred to comply with the Commission's Electric Competition Rules.

APS is the largest provider of electric service in the state of Arizona. Based on information provided in the Company's application, APS served 902,000 customers (of which approximately fifty percent are residential customers) in eleven of the state's fifteen counties during the test year ended December 31, 2002 (Test Year).

RUCO's direct testimony on the proposed rate increase was filed as scheduled at 4:00 p.m. on Tuesday, February 3, 2004. RUCO opposed both the inclusion of the PWEC generation assets in APS' rate base and the recovery of the \$234 million that was written off as part of the 1999 settlement agreement. The Commission Staff also filed direct testimony on that date, as did other intervenors who are involved in the case. On February 4, 2004, Pinnacle West Capital Corporation (the parent company of APS) stated, in an 8-K filing with the U.S. Securities and Exchange Commission ("SEC"), that it will "vigorously oppose" the recommendations of ACC Staff and RUCO.

Below is a comparison of what APS is proposing in its application, and what RUCO is recommending in its direct testimony:

	(A) APS PROPOSED ORIGINAL COST (\$000's)	(B) RUCO RECOMMENDED ORIGINAL COST (\$000's)	(C) DIFFERENCE [(B) - (A)] (\$000's)
DESCRIPTION			
ADJUSTED RATE BASE	\$4,207,476	\$ 3,051,479	\$ (1,155,997)
ADJUSTED OPERATING INCOME	263,870	258,992	(4,878)
CURRENT RATE OF RETURN (L2 ÷ L1)	6.27%	8.49%	2.22%
REQUIRED RATE OF RETURN	8.67%	7.43%	-1.24%
REQUIRED OPERATING INCOME (L4 x L1)	364,788	226,578	(138,210)
OPERATING INCOME DE(SUF)ICIENCY (L5 - L2)	100,918	(32,414)	(133,332)
GROSS REVENUE CONVERSION FACTOR	1.6529	1.6537	
GROSS REVENUE INCREASE	\$ 166,807	\$ (53,605)	\$ (220,412)
CURRENT REVENUES – TEST YEAR ADJUSTED	1,940,146	1,885,120	(55,026)

PROPOSED ANNUAL REVENUE (L8 + L9)	2,106,953	1,831,515	(275,438)
PERCENTAGE AVERAGE INCREASE	8.60% ²	-2.84%	-11.44%

¹ The Company's proposed jurisdictional revenue requirement of \$166,807,000 plus \$8,283,000 of competition rules compliance charges ("CRCC").

² An average increase of 9.80% when the Company-proposed \$8,283,000 of CRCC charges are included.

Public comment on APS' rate increase request was heard by both the Commission's Chief Administrative Law Judge ("CALJ") and four of the five ACC Commissioners on Wednesday, April 7, 2004. During the public comment session, various individuals, including representatives from a number of Arizona school boards, voiced their concerns on the proposed rate increase.

On Thursday, April 8, 2004, the director of the Commission's Utilities Division informed all of the parties involved in the proceeding that representatives from APS had approached ACC Staff about the possibility of conducting settlement discussions on the proposed rate increase request. APS invited RUCO and all of the other parties to the case to take part in an initial settlement meeting scheduled for April 19, 2004, at the Commission's Phoenix office.

During a procedural conference held at the ACC's Phoenix office on April 28, 2004, the CALJ and all five Commissioners heard from the parties to the case on the results of the two settlement meetings held to date. Attorneys representing the parties to the case stated that they believed that the meetings could produce meaningful results and that the meetings should be continued. Both the CALJ and the Commissioners asked questions of the parties and made suggestions on items such as the possible intervention of state school boards. On April 29, 2004, the CALJ issued a procedural order granting a stay of the proceeding until May 26, 2004.

On Wednesday, May 26, 2004, attorneys for the parties to the case reported to the CALJ and the five Commissioners that progress was being made in the settlement talks. The parties to the case, including RUCO, asked for a continuance of the stay on the procedural time clock until Monday, June 14, 2004. The CALJ stated that she would grant the request and issue a procedural order.

At the June 14, 2004 procedural conference, the ACC's Chief Counsel (speaking on behalf of the parties to the case) requested a thirty-day continuance of the stay on the procedural time clock from the CALJ and two of the five Commissioners. The request was granted by the CALJ.

At a scheduled procedural conference on Wednesday, August 18, 2004, the ACC's Chief Counsel announced that a settlement agreement ("Agreement") on APS' request for an increase in rates had been reached by a large majority of the parties to the case including RUCO. The proposed Agreement represents the culmination of approximately

seventeen weeks of negotiations by representatives from APS, ACC Staff, RUCO and a wide variety of other intervenors who chose to take part in the settlement discussions.

The Agreement will provide APS with a total revenue increase of \$75.5 million over the Company's adjusted 2002 revenues of \$1.8 billion. This represents a 4.21 percent total increase, 5.59 percent lower than the 9.80 percent rate increase sought by APS in its original filing in June, 2003. APS will be permitted to acquire and include the generation assets of PWEC in the Company's rate base. APS will be permitted to recover the original cost of the PWEC generation assets less \$148 million, which represents a reasonable estimate of the value to APS' ratepayers of the remaining term of the existing power supply contract between APS and PWEC. APS also agrees to forego any present or future claims of stranded costs associated with any of these PWEC assets. APS further agrees to forego any recovery of a \$234 million write-off attributable to Commission Decision No. 61973 that approved the 1999 APS settlement agreement. The Agreement provides APS with a 10.25 percent return on common equity, an embedded cost of long-term debt of 5.80 percent and a capital structure comprised of 55.0 percent long-term debt and 45.0 percent common equity, for a weighted cost of capital of 7.80 percent for the purpose of settlement.

The Agreement also adopts a power supply adjuster mechanism ("PSA") which will allow APS to directly pass the costs of fuel to its customers. Other major points of the agreement include \$16 million in energy efficiency programs, including \$1 million for funding of programs targeted to low-income customers. The Agreement also allows for \$12.5 million in environmental portfolio standard and other renewable energy programs. Finally, the Agreement includes provisions for the competitive procurement of power on the wholesale market, nuclear decommissioning costs, a transmission cost adjuster mechanism (similar to the PSA), distributed generation, and for recovery of costs associated with bark beetle infestation.

The Agreement must be approved by a majority of the five ACC Commissioners who will vote on a recommended order and opinion ("ROO") to be written on the Agreement by the CALJ after an evidentiary hearing and review of filed testimony by parties to the Agreement. The evidentiary hearing on the Agreement has been scheduled to begin November 8, 2004. A final decision on the proposed Agreement will probably not be voted on until late December 2004.

Rio Rico Utilities Inc. – Application for Permanent Increases for Water and Wastewater Utility Services – Docket No. WS-0276A-03-0434

On June 25, 2003, Rio Rico Utilities Inc. (Rio Rico or Company) filed an application requesting rate adjustments for both water and wastewater service. Rio Rico provides utility service to approximately 4,200 water and 1,500 wastewater customers in the community of Rio Rico in Santa Cruz County, Arizona.

On June 3, 2004, an Evidentiary Hearing was convened in Tucson, Arizona.

On August 17, 2004, the Hearing Division issued its Recommended Opinion and Order.

On August 31, 2004, the matter came before the Commissioners at its Opening Meeting. The Commissioners expressed concerns whether the Company's customers were aware of the magnitude of the proposed increase for wastewater services. Consequently, to insure that the views of consumers are adequately considered, the Commission ordered a public comment session to be held in the local service area.

On September 17, 2004, Staff and Rio Rico filed a Stipulated Settlement for wastewater utility service rates and proposed amendments. RUCO did not agree to the settlement. On September 21, 2004, a public comment meeting was held at the Rio Rico Community Center. On September 28, 2004, the Commissioners approved at its Open Meeting the ROO.

The issues left unresolved, adjudicated by the Administrative Law Judge and approved by the Commission in Decision No. 67279 were:

Rate Base:

The Commission approved the Company's request to include post test year plant in rate base. The preponderance of evidence indicated the plant was installed and serving existing test year customers.

Revenues and Expenses:

The Commission approved Staff's and Rio Rico's methodology for the calculation of the property tax expense.

For the Water Division, the Commission approved test year adjusted revenues of \$1,084,065; adjusted operating expenses of \$1,052,711; producing operating income of \$31,354.

For the Wastewater Division, the Commission approved test year adjusted revenues of \$606,152; adjusted operating expenses of \$711,400; producing operating losses of \$105,248.

Cost of Capital:

The Commission approved the midpoint between Staff and RUCO variables to provide a reliable and reasonable determination that Rio Rico's Weighted Cost of Capital is 8.7 percent.

Revenue Requirements:

The Commission approved an overall increase in revenue for the two Divisions of \$1,247,533 or 73.81 percent.

COMPANY BY DIVISION	DOLLAR INCREASES		
	COMPANY	RUCO	ORDER
RIO RICO UTILITIES, INC. (Decision No. 67279, Dated 10/05/04)			
WATER	\$ 362,223	\$ 163,299	\$ 547,430
WASTEWATER	\$ 869,199	\$ 702,351	\$ 700,103

Rate Design:

The Commission approved Rio Rico's phased-in rate design for the wastewater division. The revenue increase for the wastewater division is so great a three year phase-in is necessary and reasonable to ameliorate rate shock to customers.

In the first year, the typical residential 5/8 inch meter monthly bill for wastewater will increase \$12.86 or 40 percent, from \$26.00 to \$38.86. In the second year, the increase will be another \$12.86, or 33.1 percent over year one, from \$38.86 to \$51.92. In the third year, the increase will be \$4.44, or 8.6 percent over year two, from \$51.92 to \$56.36.

The Commission approved Rio Rico's 3 tier rate design for the water division believing it appropriately addresses the goals of cost-based rates that encourage conservation while providing that all meter classes bear an equitable proportion of the revenue increase.

The typical residential 5/8 inch meter monthly bill for water will increase by \$4.67 or 26.6 percent, from \$17.61 to \$22.28.

RUCO's intervention was instrumental in illuminating its position on several rate making elements; specifically:

The potential of creating mismatches between operating revenues, expenses and rate base exist by including post test year plant additions. The only way to ensure proper matching is to adhere to a historical test year model.

The pro forma adjustment of property tax expenses should be based on the ADOR formula; when the formula is varied to project an inflated Fair Value Cash Value increases the risk the Company will over earn.

The Commission traditionally allows for the treatment of income tax on a stand alone basis.

Tucson Electric Power - Filing of General Rate Case Information by Tucson Electric Power Company Pursuant to Decision No. 62103 – Docket No. E-01933A-04-0408

In June 1999, Tucson Electric Power Company (“TEP” or “Company”) entered into a settlement agreement with RUCO, Commission Staff, members of Arizonans for Electric Choice and Competition, and the Arizona Community Action Association.

The Commission approved that settlement agreement in Decision No. 62103, dated November 30, 1999, which resolved pending litigation regarding the Commission's Retail Electric Competition Rules, provided TEP with the opportunity to recover stranded costs, implemented two rate reductions, and froze the Company's rates until 2008. TEP was also required to file a general rate case application by June 1, 2004 pursuant to Commission Decision No. 62103.

TEP filed a general rate case application with the Commission on June 1, 2004, as a rate check on the Company as ordered in Commission Decision No. 62103. Commission Staff requested additional information from TEP to satisfy general rate case information requirements, and RUCO intervened on June 10, 2004.

On September 15, 2004, TEP filed additional witness testimony that more specifically addressed the original June 1, 2004 filing.

In that application, TEP stated that (based on data collected during a 2003 test year) it is experiencing a revenue deficiency of \$112 million and the Company could be requesting a rate increase of 16.0 percent. However, because of the rate freeze requirement in Decision No. 62103, TEP cannot increase its rates seeking a determination of fair value (for the purpose of setting rates) at this time. However, TEP customers could experience a rate decrease if it is ultimately determined that the Company is over-earning.

At this time, Commission Staff is determining sufficiency of TEP's rate filing and then the Commission will issue a procedural order.

RUCO has performed an initial review of the filing, and in the coming months, RUCO's staff will conduct a thorough review and analysis of the Company's application in order to determine if the information presented in TEP's application is a fair and accurate picture of the Company's performance during the test year ended December 31, 2003. RUCO's Staff will then file written testimony, presenting the results of its analysis, and will be a part of the record in the proceeding.

Electric Industry Restructuring – Docket Nos. RE-00000C-94-0165 and E-00000A-02-0051.

In May 1994, the Commission's Utilities Division Staff (Staff) opened Docket No. RE-00000C-94-0165, to study electric industry restructuring for the State of Arizona. After

public input, the Commission adopted new rules A.A.C. R14-2-1601 through R14-2-1616 (Competition Rules) in December 1996 in Decision No. 59943.

In August 1998, the Commission adopted amendments to the Competition Rules on an emergency basis. Included in those amendments were requirements that incumbent utilities divest their generation resources to an affiliate or a third party, and that incumbent utilities acquire power for standard offer customers through competitive bids. In December 1998, the Commission adopted permanent amendments. In January 1999, the Commission suspended the Competition Rules pending further consideration. After taking additional comment on the Rules, the Commission adopted revised Competition Rules in September 1999.

Beginning in December 1998, the Commission issued CC&Ns to a number of competitive Electric Service Providers. Several of the incumbent utilities appealed the decisions granting CC&Ns to the Superior Court. In November 2000, Judge Campbell issued judgment to vacate the Competition Rules and CC&N decisions. A number of parties, including RUCO, appealed Judge Campbell's decision to the Court of Appeals. In January 2004, the Court of Appeals issued its decision finding portions of the rules unconstitutional, finding other portions beyond the scope of the Commission's authority to adopt, finding other portions required certification by the Attorney General, and vacating the CC&Ns.

In October 2001, Arizona Public Service Company filed an application for a partial variance from the Commission's rule requiring competitive procurement of power for standard offer customers, and for approval of a purchase power agreement with APS' affiliate to which it was planning to transfer its generation assets. APS' application was based on its perception that western wholesale electricity markets were unstable and that competitive acquisition of power in that market was imprudent.

In January and February 2002, each of the three Commissioners issued letters seeking information pertaining to the restructuring of Arizona's electric industry. The Commission opened a new docket (E-00000A-02-0051) to examine electric restructuring issues. Interested parties provided responses to the Commissioners' questions, and in March 2002 Staff issued a report and recommended that certain issues be addressed in the new docket.

Prior to considering APS' application for a partial variance and approval of a purchase power agreement, the Commission ordered that certain threshold issues (primarily wholesale market power and the transfer of generation assets by the incumbent utilities) be considered in what became known as Track A of the new generic docket. In addition, the Commission instructed that competitive solicitation issues be considered in a second Track B. A hearing on Track A issues was held in June 2002. In September 2002, the Commission adopted an order resolving the Track A issues. That order found that APS and Tucson Electric Power Company (TEP) have market power in certain areas; that the wholesale electricity market applicable to Arizona is poorly structured and susceptible to possible malfunction and manipulation. The order concluded that the

requirement that incumbent utilities transfer their generation assets to others is not in the public interest at this time, and suspended that rule. The Order further required APS and TEP to file necessary modifications to their codes of conduct, and required that a review of the Competition Rules be undertaken.

Track B issues were initially addressed in workshops. A hearing on unresolved Track B issues was held in November 2002, and the Commission issued its order in March 2003. APS and TEP solicited power from the wholesale market pursuant to the requirements of the Track B order. As a result, APS executed three contracts and TEP executed two contracts with alternative wholesale suppliers.

During 2003, the Commission sought comments from interested parties on possible revisions to the Electric Competition Rules. In addition, the Commission held several workshops on environmental risk management to develop criteria to weigh the environmental impact of offers received in future solicitations, and to discuss the costs and benefits of environmental mitigation. In addition, the Commission held workshops to address demand-side management (DSM) issues. No final Staff Reports have been issued on these matters yet.

CASES CLOSED IN FY 2004 **(listed in order of closing date)**

Arizona Public Service Company – Request for Rate Adjustor Mechanisms - Docket No. E-01345A-02-0403

On May 31, 2002, the Arizona Public Service Company (APS) filed a request for approval of several rate adjustment mechanisms. The request was filed pursuant to the 1999 APS settlement agreement (Decision No. 61973) that provided that “the Commission shall approve, by December 31, 2002, an adjustment clause or clauses which will provide full and timely recovery beginning July 1, 2004, of the reasonable and prudent costs.” APS’ request included the following four adjustor mechanisms:

- 1) Purchase power and fuel adjustor;
- 2) Large customer power supply adjustor;
- 3) Transition cost recovery mechanism; and
- 4) System benefits adjustor.

RUCO filed testimony in this docket on February 13, 2003, opposing the approval of the purchase power and fuel adjustor mechanisms. RUCO argued that the terms of 1999 settlement agreement related merely to a purchased power adjustor, not a fuel adjustor. RUCO further argued that since the stay of generation asset divestiture in Decision No. 65154, the purchased power mechanism was no longer warranted and did not meet the definition for automatic adjustment as defined by the Commission and the courts.

A hearing on this matter commenced on April 7, 2003. On November 18, 2003, the Commission approved Decision No. 66567. RUCO's arguments were successful as the Commission approved a purchased power adjustor, but not a fuel adjustor.

Arizona Water Company - Eastern Group Rate Case – W-01445-02-0619

On August 14, 2002, Arizona Water Company filed an application for a permanent rate increase for each of the eight water systems that comprise the Company's Eastern Group. The case involved water systems that provide service to customers located in Apache Junction, Bisbee, Miami, Oracle, San Manuel, Sierra Vista, Superior and Winkelman.

The evidentiary hearing for the case was held at the Commission's office in Phoenix during the entire week of September 22, 2003. During the hearing, an administrative law judge heard testimony presented by witnesses from Arizona Water Company, RUCO and Commission Staff. RUCO witnesses faced a total of four-and-one-half hours of cross-examination by the Company's attorneys.

During the proceeding, RUCO argued that the Commission should adopt RUCO's recommended rate base and operating expense levels which perfectly matched all of the Company's ratemaking elements. A comparison of the proposed increases in revenue by the Company, Commission Staff and RUCO are as follows:

<u>EASTERN GROUP SYSTEMS</u>	<u>COMPANY REQUESTED</u>	<u>ACC STAFF RECOMMENDED</u>	<u>RUCO RECOMMENDED</u>
APACHE JUNCTION	8.80%	-9.24%	-6.36%
BISBEE	51.12%	30.09%	24.97%
MIAMI	44.62%	14.24%	17.41%
ORACLE	26.97%	10.52%	-2.01%
SAN MANUEL	90.87%	74.83%	65.89%
SIERRA VISTA	44.15%	24.84%	8.76%
SUPERIOR	68.46%	47.76%	39.64%
WINKELMAN	34.86%	18.42%	20.68%

At a scheduled special open meeting held on Wednesday, March 10, 2004, the Commissioners approved (by a vote of 3 to 2) an amended recommended opinion and order written by the Administrative Law Judge who weighed the evidence presented at the Eastern Group hearing. The final order, Decision No. 66849, dated March 19, 2004, granted the following required increases in revenue to the eight systems that comprise Arizona Water's Eastern Group:

<u>EASTERN GROUP SYSTEMS</u>	<u>FINAL ORDER</u>
APACHE JUNCTION	-3.00%
BISBEE	32.54%
MIAMI	24.24%
ORACLE	13.04%
SAN MANUEL	77.54%
SIERRA VISTA	27.82%
SUPERIOR	50.60%
WINKELMAN	24.16%

RUCO's intervention significantly impacted this case and provided substantial cost savings to Arizona Water Company's Eastern Group ratepayers. For instance, the Company requested an approximate 50 percent average increase on all combined eight water systems. Whereas, RUCO recommended a 21 percent increase, which included rate decreases in two of the Group's eight systems. The Commission's Final Order granted a 30.87 percent overall combined increase on the eight water systems with one rate decrease (-3%) for the largest system – Apache Junction.

US West Communications, Inc.'s (now Qwest Corporation) Compliance with Section 252 of the Telecommunications Act of 1996 – Docket No. RT-00000F-02-0271

In 1996, the Congress enacted the Telecommunications Act of 1996, which detailed the requirements for incumbent local exchange carriers to offer in-region interLATA services. Section 252 of the Act provides, among other things, that any interconnection agreements shall be submitted for approval to the State Commission. The purpose of the Act is to protect competition and competitors from discriminatory behavior. Section 252 facilitates the Act by requiring the filing of interconnection agreements in order that competitive local exchange carriers can opt-in and be afforded the same opportunities as their competitors

On March 8, 2002, AT&T filed a motion with the Commission which alleged that Qwest had not filed certain agreements with the Commission under Section 252(e) of the 1996 Act. The Commission's Staff opened a separate docket on April 8, 2002, to consider the 252 issues. RUCO intervened in the 252 docket and undertook a very aggressive investigation. RUCO determined that reasonable grounds existed to believe that Qwest entered into a scheme with McLeodUSA and Eschelon to discriminate against other competitors and against competition in general. RUCO requested additional time to audit the three companies in an effort to determine exactly the full extent of the scheme. A procedural conference was held on September 19, 2002, to determine the procedure that the Commission would follow in considering the issues.

On November 7, 2002, the Administrative Law Judge issued her Procedural Order setting forth due dates for the filing of testimony and scheduling a hearing. The hearing took place from March 17-20, 2003. Post-Hearing Briefs were filed. On July 25, 2003, prior to the issuance of a Recommended Opinion and Order, Staff and Qwest filed a Notice that they had reached a Settlement Agreement resolving the outstanding issues in three dockets (including the 252 docket) and requesting a procedural conference. The Settlement Agreement provided for, among other things, approximately \$22 million in payments by Qwest through a variety of measures designed to remedy the harm caused by Qwest's improper conduct.

RUCO considered the Settlement Agreement but believed that it did not go far enough to remedy the harm. RUCO believed that Qwest needed to be held accountable either by a finding of the Commission that Qwest engaged in unlawful conduct or that Qwest admit to its improprieties. Other interveners also opposed the Settlement Agreement and the matter was scheduled for hearing. A hearing was held to consider the proposed Settlement Agreement on September 16 and 17, 2003. Thereafter, the parties filed Post-Hearing Briefs.

The Administrative Law Judge issued her decision, exceptions were filed and the matter was scheduled for Open Meeting. On April 30, 2004, the Commission issued its Decision. The Commission rejected the Settlement Agreement and found that Qwest's actions violated Section 252 of the 1996 Telecommunications Act, as well as various

state laws and the Commission's Rules. The Commission, among other things, assessed a penalty against Qwest for its violations of federal and state law of \$8,764,000. Qwest was further ordered to pay its Arizona competitors a sum not to exceed \$11,650,000. The Commission imposed further regulatory safeguards on Qwest to assure Qwest continues to comply with the law in the future.

RUCO was instrumental in bringing this case before the Commission. RUCO was steadfast in making sure Qwest was held accountable for its misconduct. The Commission concurred and for the first time in Arizona, Qwest was found to have willfully and intentionally violated state and federal laws before this Commission. The penalty assessed is the largest the Arizona Corporation Commission has ever assessed against any utility.

Southwest Gas Corporation - Pre-Approval of Costs in Silver Canyon Pipeline Project – Docket No. G-01551A-04-0192

On March 12, 2004, Southwest Gas Corporation ("Southwest Gas" or "Company") filed an application with the Commission requesting pre-approval of cost recovery for the Company's participation in Kinder Morgan Energy Partners, LP's ("Kinder Morgan") proposed Silver Canyon Pipeline Project. The proposed pipeline will run roughly east to west across Arizona from Window Rock (just north of Interstate 40 on the New Mexico border) to Ehrenberg (near Interstate 10 on the California border).

In the application, the Company stated that the agreement with Kinder Morgan will provide Southwest Gas with access to currently less expensive natural gas supplies in the San Juan Basin (located in New Mexico) in addition to natural gas supplies it now receives from the West Texas Permian Basin (through pipelines operated by El Paso Corporation). In addition to seeking pre-approval of the Company's additional capacity costs in the Silver Canyon Pipeline, Southwest Gas is also proposing that these new costs be recovered from ratepayers through the Company's existing purchased gas adjustor (PGA) mechanism in the same manner in which its present interstate pipeline capacity charges are being recovered. Southwest Gas filed the application pursuant to a Commission policy statement issued on December 18, 2003, in which the Commission recognized that the current need for additional natural gas infrastructure in Arizona warranted the consideration of pre-approval of costs and the adoption of alternative cost recovery methods.

RUCO filed a motion to intervene on March 25, 2004. In the months that followed, RUCO's staff issued data requests to gain additional insight into the Company's request and hosted several meetings with Commission staff and representatives from Southwest Gas. After weighing the information that was obtained during this period, RUCO staff concluded that the Company's request was reasonable and that ratepayers would not be impacted adversely by it. RUCO's support of both Southwest Gas' position and the Commission Staff's recommendations in the matter were noted in the Commission Staff report that recommended approval of the Company's request. In the regular open meeting held at the Commission's Phoenix office on June 24, 2004,

Commissioners approved Southwest Gas' request for pre-approval of cost recovery by a 5 to 0 vote.

Arizona-American Water Company, Inc. - Application for Increases in Rates and Charges for Water and Wastewater Services in Ten of its Districts – Docket No. W-01303A-02-0887 et al.

On November 22, and December 13, 2002, Arizona-American Water Company, Inc. (Arizona- American, AZ-AM or Company) filed an application for a determination of the current fair value of its utility plant and property and for increases in its rates and charges based thereon for utility service in selected water and wastewater districts.

This consolidated proceeding requests increases in the rates and charges for ten systems (Districts) under the ownership umbrella of Arizona-American.

These ten Districts were previously owned by Citizens' Communications (Citizens or CUC). Arizona-American purchased all of the water and wastewater assets of Citizens in Arizona as approved by the Commission in Decision No. 63584, dated April 24, 2001, with AZ-AM assuming operational control on January 15, 2002.

The Company had requested increases ranging from 6.80 percent to 86.74 percent. RUCO's testimony recommended rate decreases for 4 out of the 10 systems ranging from -17.98 percent to 31.70 percent. RUCO's testimony clearly showed the rate increases proposed by the Company were unwarranted.

A nine-day Evidentiary Hearing began in Phoenix on December 4, 2003.

Rate Base:

The Commission approved Staff's adjustments to the Rate Base related to Plant in Service and corresponding adjustments to Accumulated Depreciation. The Company was unable to provide a logical and appropriate explanation of its treatment of unidentified, retired, salvaged and/or used and useful plant.

The Commission authorized the Company's unusual methodology to use the Half-Month Convention for determining depreciation expense levels for plant additions and retirements.

The Commission approved RUCO's adjustment to correct the Mohave District's Advances In Aid of Construction balance and the Mohave District's Contributions In Aid of Construction balance.

The Commission approved Staff's and AZ-AM's methodology for the calculation of the property tax expense.

Fair Value Rate Base:

The Commission ordered that the average of the adjusted OCRB and RCND provides a reasonable measurement of the current value of the Company's property dedicated to public service. A 50/50 weighing of the OCRB and RCND is the legitimate basis to determine the Company's FVRB and there was no legitimate basis presented by the Company for departing from this traditional ratemaking methodology.

Operating Income:

The Commission approved RUCO's expense levels for Corporate Overheads, Service Company charges, and Salaries and Wages.

The Commission approved RUCO's Rate Case Expense level. The Commission agreed with RUCO that the Company chose the test year for its application and believes that ratepayers should not be made to bear the burden of the Company's choices to incur unreasonable increases in expenses. The Commission concurs with RUCO that at some point the Company must mitigate the costs associated with retaining outside counsel or consultants to prepare and litigate its rate case filings.

Cost of Capital:

The Commission approved the methodology and variables used by Staff to provide a reliable and reasonable determination that AZ-AM's Weighted Cost of Capital is 6.5 percent.

Rate of Return:

The Commission authorized the traditional ratemaking methodology of applying a fair value rate of return to the Company's FVRB, as recommended by both RUCO and Staff and determined it is in accordance with the mandates of the Arizona Constitution.

Authorized Increase/Decrease:

The Commission approved an overall increase in revenue for the ten Districts of \$1,340,249 or 3.79 percent.

COMPANY BY DIVISION	DOLLAR INCREASES		
	COMPANY	RUCO	ORDER
ARIZONA-AMERICAN WATER COMPANY (Decision No. 67093, Dated 06/30/04)			
SUN CITY WEST WATER	\$ 1,482,414	\$ 545,792	\$ 547,430
SUN CITY WEST WASTEWATER	1,965,956	1,079,850	934,366
SUN CITY WATER	5,371,706	1,572,021	1,476,373

SUN CITY WASTEWATER	639,391	(856,821)	(745,794)
TUBAC	216,475	50,353	81,434
AGUA FRIA WATER	1,788,275	(241,111)	(269,577)
ANTHEM WATER	1,610,727	(305,056)	(280,170)
ANTHEM WASTEWATER	1,200,604	74,649	226,725
MOHAVE WATER	685,950	(698,249)	(675,701)
HAVASU WATER	206,142	2,467	45,163
 TOTAL	 \$ 15,167,640	 \$ 1,223,895	 \$ 1,340,249

On July 12, 2004, the Company filed for a rehearing on the following basis:

Rate Base issues violate fair value standards are unlawful and violates the Arizona Constitution.

Authorized Rate of Return failed to recognize recent increases in interest rates.

Rate Case Expense is unrealistic in view of the actual costs exceeding \$1 million.

On August 27, 2004, the Company appealed to the Court of Appeals of the State of Arizona for a review of Decision No. 67093. At the time of publication, the outcome of this appeal is unknown.

RUCO's intervention was instrumental in illuminating the inappropriateness of the Company's filing, resulting in excessive, unsubstantiated expense levels; specifically:

- 1) The Company's selection of a test year in which it did not own or operate the systems made the entire process suspect, unreliable, complicated and time consuming.
- 2) The Company's inaccurate calculations of Corporate Overheads, Service Company charges, and Salaries and Wages were grossly inflated.
- 3) The Company's determination to use non-traditional unconstitutional ratemaking principles to recover the acquisition premium was contrary to a prior Commission Decisions.
- 4) The Company's attempt to inflict upon the ratepayers the excessive rate case expenses from the runaway costs associated with pursuing precedent setting RCND issues is unconstitutional.
- 5) The Company's request to include unknown and unmeasured charges associated with the expansion of the Tolleson Wastewater Facilities violated established ratemaking principles.

RUCO was able to effectively demonstrate the errors in the Company's assertions in such a way that the Administrative Law Judge and the Commissioners agreed with RUCO on most of the major issues. RUCO's diligence in this proceeding had a direct impact on AZ-AM's residential customers by reducing the overall rate increase from the Company's request of 27.58 percent to an acceptable 3.79 percent.



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APPENDIX

COMMONLY-USED ACRONYMS AND TERMS

The following terms are used throughout the case summaries:

ACC – Arizona Corporation Commission
ADOR – Arizona Department of Revenue
APS – Arizona Public Service Company
AZ-AM – Arizona-American Water Company
CALJ – Chief Administrative Law Judge
CC&N – Certificate of Convenience and Necessity
Citizens – Citizens Communications Company
Commission – Arizona Corporation Commission
DEQ – Department of Environmental Quality
DSM – demand-side management
FVRB – fair value rate base
OCRB – original cost rate base
PSA – power supply adjuster
PWEC – Pinnacle West Energy Corporation
RCND – reconstruction cost new depreciated
ROO - Recommended Opinion and Order
Saguaro Acquisition – Saguaro Acquisition Corp.
Staff – ACC Utilities Division Staff
TEP – Tucson Electric Power Company
UniSource – UniSource Energy Corporation (parent of TEP)